CAMBRIDGE
INVESTMENTS LIMITED

THE **CAMBRIDGE** WEEKLY

13 January 2020

Lothar Mentel

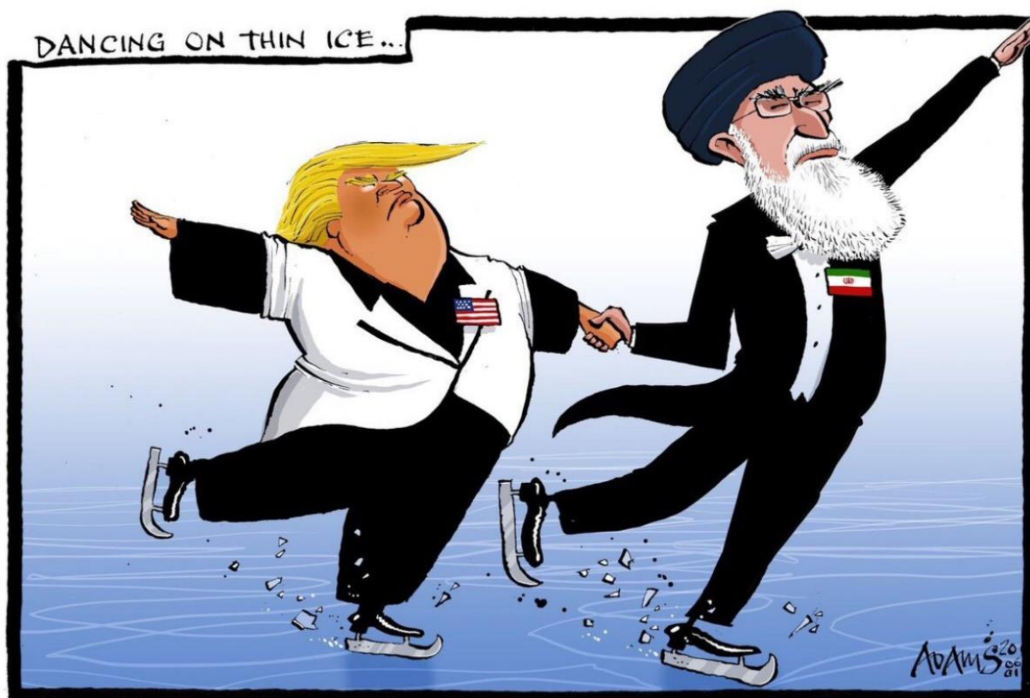
Lead Investment Adviser to Cambridge

DISCLAIMER

This material has been written on behalf of Cambridge Investments Ltd and is for information purposes only and must not be considered as financial advice.

We always recommend that you seek financial advice before making any financial decisions. The value of your investments can go down as well as up and you may get back less than you originally invested.

Please note: All calls to and from our landlines and mobiles are recorded to meet regulatory requirements.



Source: Christian Adams, 8 January 2020

So far so good

Compared to last week's 'brink-of-war' geopolitical shock start to the year over the US-Iran tensions, this week has brought relatively positive economic news, with not much to upset global markets, even if the general news flow was tragic from a humanitarian and environmental perspective. At the moment, no new bad news is good news in investments, with constant talk of "liquidity" (for institutional investors) and "dry-powder" (for private equity groups). Whether investors' money is wet or dry, does not matter. The US's NASDAQ tech stock index is above 9,000 for the first time, as we write.

Stock markets took it decidedly positively that Iran put more effort behind domestic propaganda than actual hostilities against the US and its allies. This allowed a return of the quiet with which the year originally started, even though many political observers warn that this may not be the end of the affair.

Turning back to the UK, Brexit may appear to be less of a concern for businesses, but the start of the UK-EU negotiations has done enough to take the edge off sterling, with our currency dropping back another 1% against the US dollar through the course of the week. Despite both sides being quite vocal about various positions (on fishing, the year-end deadline, not accepting EU rules, etc.), the dialogue appears to be reasonably direct and civil. We should expect lots more noise, and probably moves to expose confrontational positions quite quickly, in order to deal with the issues as soon as possible. As long as the noise is constant enough without being nasty, investors will become inured to it and things could appear to become less risky.

Meanwhile, the Chancellor announced that the budget will be on March 11th. Investment spending is highly likely to rise, and it appears Javid is intent on cutting taxes. That means debt will rise, and the Debt Management Office announced that it is raising planned gilt sales for 2019-2020 by £14bn to £136.8bn. Still, clearly, the government wants to limit debt-raising as much as possible. A swift current spending review is under way already with the clear imperative to cut costs ahead of this date. This will be a difficult trick to pull-off if the Conservatives new-found supporters are not to be upset.

Perhaps we should expect Brexit noises to increase around the time of the budget, in order to keep the electorate thinking positively about the new government and that might make sterling struggle a bit at that point.

The Bank of England Governor, Mark Carney, is soon to become Governor Andrew Bailey. Long live the governor. Bailey is an historian by training rather than an economist (Carney and his predecessor, Mervyn King were both economists). His time in charge of both the major financial regulation bodies has been not without issue. However, he is very well regarded by those he works with and beyond – a team-player.

The Monetary Policy Committee has had a hard time being seen as effective under Mark Carney, though one would be hard-pressed to come up with a more difficult set of circumstances. Carney gives way to Bailey on March 16th, just after the budget. In the meantime, he has been sounding more dovish this week, something that may be a function of the recent currency stability.

The Bank of England held a private conference yesterday (Thursday 9th) to discuss the role of inflation targeting. Invitees included Philip Lane, the ECB Chief Economist, and John Williams, the President of the Federal Reserve Bank of New York. After the August Central Banker Conference at Jackson Hole in the US, deliberations on "the effective lower bound" for interest rates have been growing. It may not be 0% but it looks like it is higher than -1%, at least for the major economies. It also seems that expectations of rates below 0% should not be maintained. This seems to be mostly because of the impact on commercial banks and their profitability, which, whether one likes them or not, remain crucial for any economy's health. Both BoJ and the ECB have been allowing rates for longer maturity bonds to rise, so that the volume of bonds yielding below 0% has shrunk substantially. This chart from Bloomberg that shows that total volume over time:

There is a lot going on in bonds at the moment, and not just because of potential central bank policy changes.

If equity markets are signalling a long and decent period of revenue growth (which the high relative valuations of stocks suggest to some degree), it will be associated with expectations of stable economic growth. Despite a slightly weaker than expected US non-farm payroll figure for December (+145,000, against expectations of +160,000), labour markets are tight. Wage rises are increasing which should support consumer demand – but also revive inflationary pressures. This is also true for Europe and the UK, even for China and Japan despite a slight pull-back. Meanwhile commodities have started to rise, again despite the slight fall-back in oil prices this week.

Following last year's very strong return picture across stock and bonds, the relative stability of global economic growth should put a solid base under equity prices, even though last year's rises have 'front-run' much of the actual positives to come. This make a 2020 repeat of 2019's return picture fairly unlikely. However, higher growth and higher inflation are not good for fixed coupon bonds, even if central banks are saying they will keep short-term interest rates at their low levels. Indeed, the act of not changing short-term interest rates could well make long-term interest rates higher, not lower – which will put downward pressure on bond values.

With relative calm returned, 2020 once again looks likely to bring a return of stable if low economic growth rates, which, because already largely priced in by stock markets, is more likely to lead to less dynamic returns and to a consolidation of government bond valuations. The more the global economy surprises to the upside the worse for bonds. Not surprising then that at the moment we are watching more and more closely the dynamics that drive bond prices.

Asset class returns for December 2019, 2019 and the full decade

Asset Class	Index	December	2019	2010s	2010s Ann
Equities	FTSE 100 (UK)	2.8	17.3	112.7	7.9
	FTSE4Good 50 (UK Ethical Index)	2.8	13.9	47.4	4
	MSCI Europe ex-UK	1	20	113.6	8
	S&P 500 (USA)	0.6	26.4	347.5	16.3
	NASDAQ (US Technology)	1.5	34.1	580.2	21.3
	Nikkei 225 (Japan)	-0.3	15	124.6	8.5
	MSCI All Countries World	1.1	21.7	193.5	11.5
	MSCI Emerging Markets	4.9	13.8	83.8	6.3
Bonds	FTSE Gilts All Stocks	-1.3	6.9	67.5	5.3
	£-Sterling Corporate Bond Index	0.1	11	89.1	6.6
	Barclays Global Aggregate Bond Index	-1.8	2.7	53.9	4.4
Commodities	Goldman Sachs Commodity Index	4.5	13.1	-24.9	-2.8
	Brent Crude Oil Price	6.5	17.9	10.8	1
	LBMA Spot Gold Price	2.1	14.2	70.1	5.5
Inflation	UK Consumer Price Index (annual rate)*	0.1	-	-	-
Cash rates	Libor 3 month GBP	0.1	0.9	6.6	0.6
Property	UK Commercial Property (IA Sector)*	-0.8	-0.8	58.3	4.7

Data sourced from Morningstar Direct as at 31/12/19. * to end of previous month (30/11/19). All returns in GBP

It has been the end of the month, the year and the decade and so we decided to run a slightly more comprehensive monthly asset class returns overview table than we usually do. However, whilst the last decade brought above average returns, that provides no indication of what will happen over the coming 10 years. Stock market returns will be driven by general economic development, which will likely be bumpy from time to time, but there are reasons to believe that our environmental challenges as well as technological opportunities create catalysts for growth that were absent in the last decade.

The longer terms bond outlook has to be less positive. With interest rates and bond yields pretty much as low as they can be, no further significant upside can come from further rate declines. Rising rates in response to improved economic growth on the other hand could quickly turn very meagre positive bond yields into absolute return negatives for bonds as their valuations have to fall in a rising rates environment.

Emerging trends from the 2020 Consumer Electronics Show (CES)

The start of a new year, and even new decade, means it is time for 4,500 of the world's biggest and smallest companies in the technology space to come together in Las Vegas for the Consumer Electronics Show (CES) and unveil their latest gadgets and gizmos.

Nearly 200,000 enthusiasts and entrepreneurs attended this year's exhibition, getting "hands-on" with the tech being released later in 2020, and testing "stuff" arriving in the coming decade.

There is always a lot of tat – a web-connected toilet paper dispenser anyone? – and software in "development" that will never see the light of day.

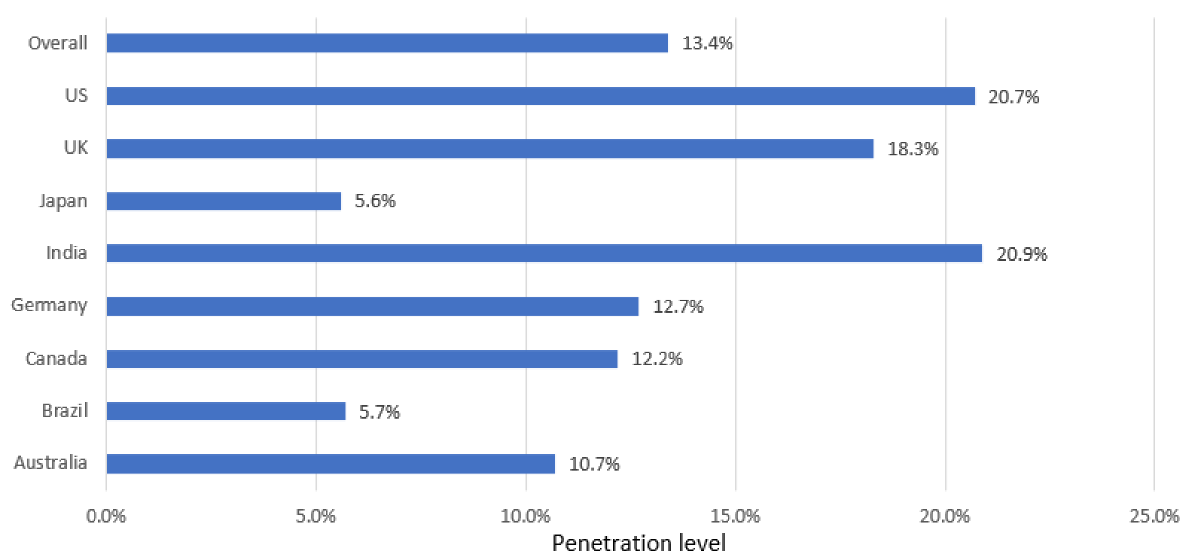
However, the CES is useful for providing insights into potential longer-term investment themes and also current opportunities.

Last year's longer-term themes included mobility and the science fiction favourite, flying taxis. The more immediately available products included Nvidia's RTX real-time ray-tracing graphics cards and Beyond Meat's plant-based burgers.

The graphics cards helped Nvidia's 2019 share price to rise 69%. Beyond Meat's $25 May IPO was a sensation: by the end of July the share price hit $235 – admittedly, it is now "only" $90 or +260%.

This year's exhibition focused more on the practical things you will be able to buy and use in 2020.

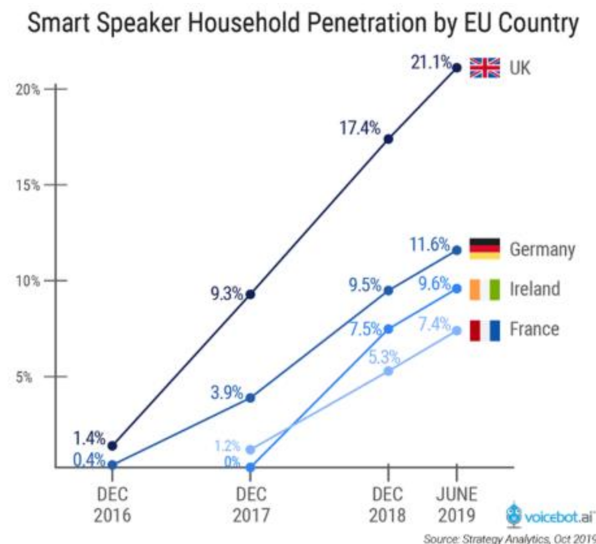
Voice controlled smart-everything was everywhere. Since Amazon launched the first voice-controlled smart speaker at the end of 2014, the product category has grown exponentially, following the typical "S" adoption curve.



Source: IHS Markit, online survey of 19,286 respondents

According to Pew Research, 25% of Americans have a smart speaker like Amazon's Echo or Google's Home (IHS Markit survey of November 2018 had 20.9%, as shown above). The penetration of such devices into emerging markets (as shown by India's 20.9%) is noteworthy.

Strategy Analytics review of the EU shows Brits keeping up with the most forward of tech using countries, with 21.1% of households owning such a device (up from the IHS Nov-2018 of 18.3%).



2020 is the year that smart speakers become more connected to more devices, over both WiFi and newer 5G mobile networks. Thermostats, drones, fridges, washing machines and even our cars will get smart and interact with us.

Users of these devices say it takes little time before pushing buttons feels antiquated. Some two-year-olds are already able to control the colour of the Philips Hue – Google Home lightbulbs – making a home feel like a rave from the 1980s. Our children will look back in horror and ask, "did you really have to physically press *that* to access things?".

Electric vehicles (EV) and new transport systems were being show-cased. EVs have become a big part of CES in recent years and the 2020s show saw stunning new concepts from both Mercedes (AVTR) and Sony (yes Sony with its Vision S electric concept car) fitted out with arrays of its best sensors and audio technologies as a showcase for what future vehicles would be capable of.

While Tesla was not at CES, it has high visibility with its market capitalisation this week, for the first-time surpassing that of General Motors and Ford combined, despite only having a fractional share of the global auto market (0.5%). So, no surprise that in 2020 the big players are finally fighting back. Volkswagen is spending the best part of €30 billion by 2023 (roughly equal to its cumulative profits between 2015/18) with its new ID range, and other firms are also investing heavily. Meanwhile, car giant Toyota announced its plan to build a next generation smart city for 2000 residents near Mount Fuji, called Toyota Woven City, as a testbed for a range of the latest technologies, such as smart electricity grids, AI, autonomous cars, etc.

8K TVs and Augmented Reality (AR). 8K TVs were everywhere at CES, but the lack of a viable ecosystem and available content is not stopping TV makers like Samsung and LG pressing ahead with more advanced sets. There has been plenty of hype around AR, but 2020 should finally see some viable products in an industry predicted by Market Research Future to be worth $31 billion by 2023. Samsung announced a set of AR glasses at the show, while Chinese start-up Nreal's AR glasses, which plug into an Android smartphone, were seen by many as one of the standout products of CES. Many see AR as the next logical

step from smartphones with some extremely valuable application potential – imagine being an aircraft mechanic fixing an engine overlaid with manuals and schematics overlaid digitally through AR glasses.

Away from CES the 2020s are shaping up to be an exciting decade in terms of progress in all applications of technology. Artificial Intelligence continues to attract significant investment and will see more opportunities. Further strides are likely to be made in artificial meats, Impossible Foods recently launched a plant-based 'pork' with the rumour that Burger King will offer the product in its breakfast menu.

New medical advances in gene editing will see new medical scientists using tiny molecular scissors to edit genes and splice them in different ways in order to help treat disease. Therapeutics, Intellia Therapeutics and Editas Medicine are the companies leading the charge.

The University of Bristol took computing a big step forward this week announcing it had achieved the world's first chip-to-chip quantum teleportation bringing both quantum computing and quantum internet closer to reality.

Lastly, this decade will likely see Space Race 2.0 kick into high gear, as competition intensifies between the US and China over who will have the first permanent lunar base – and in the US the technology is being driven by private companies. Who knows, perhaps Elon Musk will make it to Mars first?

Trying to avoid the noise from CES is not always simple and it can be easy to be sucked into the hype around the 'next big thing' that fails in reality. It is therefore worth taking a step back and attempting to look at longer-term trends and potential opportunities in a level-headed way. From our vantage point, we observe that if the past decade saw technology leading to the rise of social media and new forms of online entertainment, then the coming decade has the potential to see new technologies applied to improve productivity in the services sector (IA) and consumer convenience (self-driving EVs, household automation and robots).

Emerging markets – a re-introduction

The Economist dates the term "emerging markets" back to 1981, invented by fund manager, Antoine van Agtmael. Struggling to launch a "Third-World Equity Fund" he "At last .. came up with a term that sounded more positive and invigorating: emerging markets. 'Third world' suggested stagnation; 'emerging markets' suggested progress, uplift and dynamism."

Now established, "Emerging Markets" (EM) is something of a catch-all term. Most diversified investment portfolios have a certain amount of capital allocated to EM assets as opposed to "Developed Markets" (DM).

Access to global equity markets has been transformed since 1981, so what actually makes a country or market "emerging" rather than "developed" in today's global economy?

Some definitions tie EM status to political instability: political scientist Ian Bremmer defines it as "a country where politics matters at least as much as economics to the markets".

Economists see EMs as (usually) export-led, producing lower-tech goods or services, often heavily involved in the commodities industry, needing foreign capital due to a lack of domestic savings.

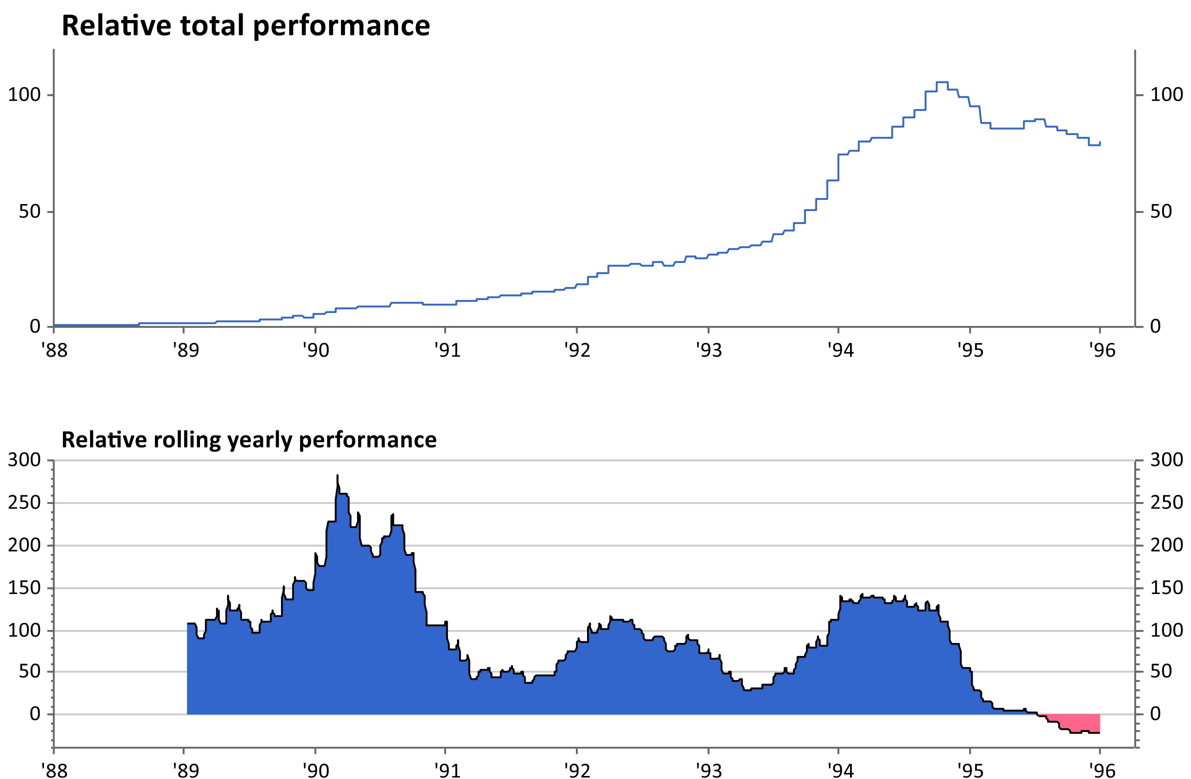
Either way, from a geographic perspective, the most workable solution is to use an Index of countries based on a visible methodology. The most widely is the MSCI's Emerging Market index (instituted in 1988) and Frontier Market index (instituted in 2006). The MSCI has a methodology that results in countries shifting in and out of the indices, but this happens relatively infrequently

EMERGING MARKETS			FRONTIER MARKETS			
Americas	Europe, Middle East & Africa	Asia	Europe & CIS	Africa	Middle East	Asia
Argentina	Czech Republic	China	Croatia	Kenya	Bahrain	Bangladesh
Brazil	Egypt	India	Estonia	Mauritius	Jordan	Sri Lanka
Chile	Greece	Indonesia	Lithuania	Morocco	Kuwait	Vietnam
Colombia	Hungary	Korea	Kazakhstan	Nigeria	Lebanon	
Mexico	Poland	Malaysia	Romania	Tunisia	Oman	
Peru	Qatar	Pakistan	Serbia	WAEMU[2]		
	Russia	Philippines	Slovenia			
	Saudi Arabia	Taiwan				
	South Africa	Thailand				
	Turkey					
	United Arab Emirates					

The index above is from the MSCI as of December 2019.

EM entered mainstream investing for one reason – performance. In its early days, Antoine van Agtmael and other EM fund managers did spectacularly well. Gains in the highly risky new investments outperformed the developed markets so much that, from 1988 (the institution of the MSCI EM Index) to mid-1995, an investment of £1 would have returned 100 times that of a DM investment. The chart below shows the remarkable path:

MSCI: Emerging Market Index vs. World (to 1996)



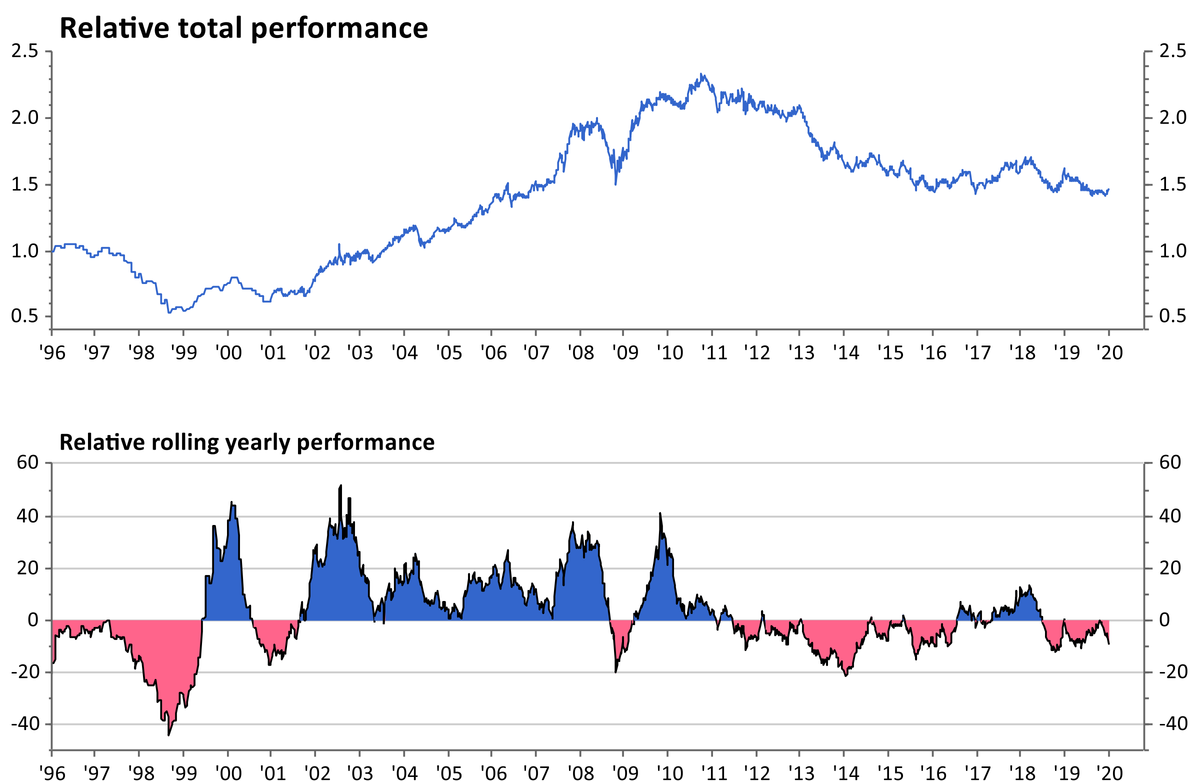
Source: Factset, MSCI

However, from mid-1995 to the end of 1998 the environment changed dramatically. The Asian Tiger Crisis and the Russian Debt Crisis meant EM investments halved relative to developed markets. £1 became 50p, for DM investments on the other hand, £1 would become £1.75.

The good times returned. Emerging markets resumed outperformance through 1999 to 2011. However, this time it was of a different order. EM investments went from £1 to £5.59, 4-times better than DM - still good, but not the 1990s.

But from 2011, EM has not been relatively poor. £1 has become £1.52 in EM equity investments, but DM would be £2.82. Relatively, EM has underperformed by over 30%.

The next chart shows the relative performance of EM versus a global portfolio from the beginning of 1996 to now:



Today, in a global economy, thinking of EM equities as a single block may not help and analysis as economies mature at differing rates must be deeper.

We should not confuse EMs as regions. The MSCI EM index tracks broad equity market moves at the aggregate level for EMs, and so is sensitive to broad macro factors or changes in sentiment from investors. But deeper economic and political factors are also relevant to the overall investment picture. The best performing EM over the last few months, for example, has been Argentina.

The investments that are available within a country are clearly an important factor to consider early. China (yes, it is classified as an emerging market economy) has exhibited stellar growth in most sectors of its economy over the last 20 years, to the benefit of many of its companies. But some of that growth was concentrated in the large state-owned enterprises, to which foreign investors have no access, and, for much of that period, even many of the private companies have had huge barriers to access for foreigners.

Identifying what a country's major stocks or stock indices are is therefore crucial. So too is identifying its major bonds or bond issuers – usually, but not always, the government.

In terms of the underlying economy, one of the main factors of this will be a country's sensitivity to trade. Export-led countries will tend to do better when global demand, or demand from their main trading

partners, is strong. When demand is weak, we should normally expect those countries to struggle - as has been the case during the US-China trade confrontation.

Another huge factor is currency value. It is a common narrative that EM companies struggle when the US dollar is strong, due to their large proportion of dollar-denominated debts.

Often political risks are big enough to scare away investors, who may fear revolutions or nationalisation, or simply weak corporate governance leading to value being distributed to stake holders other than shareholders. Whilst difficult to quantify, an analysis of a country's political status is therefore crucial.

What does matter is an economy's dependence on foreign investment, both direct (subsidiaries, start-ups) and through domestic stock markets. Countries that are particularly reliant on external sources of capital will be more sensitive to changes in global liquidity – coming from either investor sentiment or global central bank policy. Those that went through the lead up to 1997/8 EM Debt Crisis will not forget it easily.

As well as how the world affects a country, it is also important to consider how that country affects the world. The types of goods or services a country buys and sells, and how its demand affects others are key factors in this. Investable Chinese assets make up a relatively small proportion of global investment portfolios, but its economic health is vital to the demand side of the wider global economy and global capital markets – the economic boom of 2015/16, was largely driven by China.

In practical terms, using this framework, we can consistently evaluate and compare individual EMs as investment propositions. Doing this also allows us to see more clearly overall links between different EMs and trends which affect overall EM performance.

Over the coming few months, we will look at the individual countries in more depth in these pages. Of course, we should say that the reason for this is that we think the emerging markets as a whole could become more attractive through the course of this year.

CAMBRIDGE
INVESTMENTS LIMITED

13th January 2020

Global Equity Markets

Market	FRI 15:26	% 1 Week*	1 W	Technical Short	Technical Medium
FTSE 100	7602.4	-0.3	-20.0	⬀	→
FTSE 250	21614	-1.7	-374.0	↗	↗
FTSE AS	4214.7	-0.5	-21.0	↗	⬀
FTSE Small	5967.5	0.0	1.0	↗	⬀
CAC	6048.9	0.1	4.7	⬀	↗
DAX	13533.8	2.4	314.6	⬀	↗
Dow	28972	1.2	337.0	⬀	↗
S&P 500	3281.1	1.4	46.2	↗	↗
Nasdaq	9010.6	2.5	216.7	↗	↗
Nikkei	23850.6	0.8	194.0	⬀	↗
MSCI World	2379.9	0.7	16.7	↗	↗
MSCI EM	1129.4	0.5	5.5	↗	⬀

Global Equity Market - Valuations

Market	Div YLD %	LTM PE	NTM PE	10Y AVG
FTSE 100	4.7	18.4	13.5	13.2
FTSE 250	3.7	25.7	15.1	14.2
FTSE AS	4.5	19.5	13.5	13.4
FTSE Small	3.3	190.3	-	13.9
CAC	3.0	21.7	14.9	13.5
DAX	2.9	25.1	14.5	12.5
Dow	2.2	19.9	17.5	15.0
S&P 500	1.8	21.9	18.8	16.0
Nasdaq	0.9	28.5	23.4	18.0
Nikkei	1.9	19.0	18.2	17.2
MSCI World	2.3	20.8	17.3	15.2
MSCI EM	2.6	15.7	13.3	11.9

Top 5 Gainers / Top 5 Decliners

Company	%	Company	%
easyJet	7.9	NMC Health	-19.7
Int'l Consol Air	6.9	M&S	-10.5
Brit-AM Tobacco	4.1	Fresnillo	-6.6
GVC	3.6	British Land	-6.1
Vodafone	3.3	Mondi	-5.9

Currencies / Commodities

Pair	last	%1W	Cmdty	last	%1W
USD/GBP	1.307	-0.1	Oil	65.17	-5.0
GBP/EUR	0.850	0.4	Gold	1556.0	0.2
USD/EUR	1.11	-0.5	Silver	18.10	0.2
JPY/USD	109.59	-1.4	Copper	280.5	0.6
CNY/USD	6.920	0.7	Aluminium	1803.5	-0.1

Fixed Income

Govt bond	%Yield	1 W CH
UK 10-Yr	0.8	0.0
UK 15-Yr	1.0	0.0
US 10-Yr	1.8	0.0
French 10-Yr	0.0	0.0
German 10-Yr	-0.2	0.1
Japanese 10-Yr	0.0	0.0

UK Mortgage Rates

Mortgage Rates	Dec	Nov
Base Rate Tracker	2.53	2.50
2-yr Fixed Rate	1.45	1.44
3-yr Fixed Rate	1.56	1.58
5-yr Fixed Rate	1.69	1.69
10-yr Fixed Rate	2.61	2.61
Standard Variable	4.28	4.28

* The *% 1 week* relates to the weekly index closing, rather than our Friday p.m. snapshot values
** LTM = last 12 months' (trailing) earnings;
***NTM = Next 12 months estimated (forward) earnings

For any questions, as always, please ask!

If anybody wants to be added or removed from the distribution list, please email enquiries@cambridgeinvestments.co.uk

CAMBRIDGE
INVESTMENTS LIMITED

13th January 2020

Please note: Data used within the Personal Finance Compass is sourced from Bloomberg/FactSet and is only valid for the publication date of this document.

The value of your investments can go down as well as up and you may get back less than you originally invested.

Lothar Mentel